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Ratesetting

TO PARTIES OF RECORD IN APPLICATION 13-12-012 and
INVESTIGATION 14-06-016:

This is the proposed decision of Administrative Law Judge Allen. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's August 15, 2019, Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties of record may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, *ex parte* communications are prohibited pursuant to Rule 8.2(c)(4)(B).

/s/ MICHELLE COOKE for
Anne E. Simon
Chief Administrative Law Judge

AES:jt2

Attachment

Decision **PROPOSED DECISION OF ALJ ALLEN** (Mailed 7/15/2019)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric
Company Proposing Cost of Service and
Rates for Gas Transmission and Storage
Services for the Period 2015 - 2017 (U39G).

Application 13-12-012

And Related Matter.

Investigation 14-06-016

**DECISION GRANTING PETITION FOR MODIFICATION OF
DECISION 16-06-056 TO REFLECT TAX REDUCTIONS
FOR PACIFIC GAS AND ELECTRIC COMPANY**

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**DECISION GRANTING PETITION FOR MODIFICATION
OF DECISION 16-06-056 TO REFLECT TAX REDUCTIONS
FOR PACIFIC GAS AND ELECTRIC COMPANY**

Summary

This decision grants the Petition for Modification of Decision (D.) 16-06-056 filed by Pacific Gas and Electric Company (PG&E), to the extent adopted herein, for revision of its 2018 attrition-year revenue requirement for its gas transmission and storage system, in order to reflect the effects of the Tax Cuts and Jobs Act of 2017.

PG&E requested Commission approval of a \$57.717 million reduction in the 2018 revenue requirement authorized by the Commission in D.16-06-056, to reflect the effects of the new legislation. Although we find PG&E's methods of calculating these reductions appropriate for the most part, we direct PG&E to modify its calculations in several instances. PG&E is ordered to revise its calculations accordingly so that the finalized reductions may be passed on to customers later this year.

1. Procedural Background

In Decision (D.) 16-06-056, the Commission adopted revenue requirements for Pacific Gas and Electric Company's (PG&E's) Gas Transmission and Storage (GT&S) system for 2015-2017. The Commission also adopted a third attrition year for the that GT&S rate case cycle, applying an escalation factor to calculate and authorize PG&E's revenue requirement for 2018.

Also in this proceeding, the Commission subsequently issued D.16-12-010 to allocate the disallowance imposed on PG&E for violations relating to the September 9, 2010 gas transmission pipeline explosion and subsequent fire in San Bruno, California. The total \$850 million disallowance was allocated

between capital and expense and PG&E adjusted its authorized GT&S revenue requirement accordingly.

On December 22, 2017 the Tax Cuts and Jobs Act of 2017 (TCJA) was signed into law. The TCJA introduced new federal tax laws and made changes to the Internal Revenue Code (IRC) that substantially impacted PG&E beginning in the 2018 tax year. In particular, the TCJA provided for a reduction in PG&E's corporate federal income tax rate from 35% to 21%.

PG&E sent a letter to the Commission's Executive Director on January 5, 2018 proposing to submit a filing by March 31, 2018 to request a reduction in its authorized revenue requirements, as well as an implementation plan to reflect the TCJA reductions in retail customers' rates. The Director of the Commission's Energy Division sent a letter to PG&E on March 2, 2018, stating instead that PG&E should file a Petition for Modification (PFM) of D.16-06-056 no later than March 31, 2018, to propose adjustments to its GT&S revenue requirement in order to reflect TCJA-related changes for attrition year 2018.

PG&E filed its PFM on March 30, 2018. PG&E requested authority to revise its authorized 2018 GT&S revenue requirement to incorporate the effects of the lower corporate tax rate and other changes required by the TCJA. Attachment B to the PFM provides PG&E's "Report of Pacific Gas and Electric Company on Revenue Requirement Revisions from the Tax Cut and Jobs Act of 2017 on the 2015 Gas Transmission and Storage Rate Case" (PG&E Report). PG&E also provided, as Attachment C to the PFM, the sworn declaration of Mark T. Caron, Vice President of Tax for PG&E Corporation and PG&E.

PG&E's Report and Mr. Caron's declaration state that D.16-06-056 requires modification due to three major tax law changes that have significant impacts on PG&E's estimated tax expense and rate base for 2018:¹

1. Reduction of the corporate income tax rate from 35% to 21% effective January 1, 2018;²
2. Adoption of what PG&E considers to be a "mandatory" methodology to return excess tax reserves to customers (Average Rate Assumption Method (ARAM) Adjustment);³ and
3. Requirement that public utilities use Modified Accelerated Cost Recovery System (MACRS) depreciation after September 27, 2017.⁴

Based on these changes, PG&E updated its 2018 GT&S attrition year revenue requirement relating to federal tax expense in two ways. First, PG&E re-calculated its federal tax expense and deferred federal tax liabilities to directly incorporate the three changes listed above. Second, PG&E re-calculated its total rate base to reflect the indirect effect of the same changes on rate base. PG&E's approach to these calculations results in a \$57.717 million reduction to the 2018 revenue requirement authorized in D.16-06-056. The Report provided in Appendix B of PG&E's PFM presents a series of calculations that itemize the changes that net out to PG&E's proposed reduction, based on their source in the

¹ PG&E also listed a fourth major change, albeit one that does not affect PG&E's GT&S revenue requirement: the repeal of IRC Section 199 Manufacturing Tax Deduction, which was a permanent tax deduction that the Company could claim on taxable income derived from generating electricity. As PG&E explains in its Report, the GT&S rate case does not include any net income derived from generating electricity, so PG&E did not claim this tax deduction in this rate case, and therefore there is no revenue requirement impact due to this provision.

² Section 13001 of Public Law (Pub L.) No. 115-97 amending IRC Section 11.

³ Section 13001 of Pub L. No. 115-97.

⁴ Section 13201(d)(9)(A) of Pub L. No. 115-97 amending IRC Section 168k.

TCJA. PG&E's summary of the results of those calculations is presented in Table 1 below.⁵ For ease of presentation, we will use this table as the outline for our review of each of PG&E's proposed changes in the remainder of this decision.

Table 1
PG&E's Proposed Revenue Requirement Changes
Due to The Tax Cuts and Jobs Act of 2017 (\$000)

Line No.	Change in Revenue Requirement	Increase/ (Decrease)
1	Decrease due to lower taxes on equity return on rate base ⁶	(81,239)
2	Increase due to lower taxes on flow-through tax deductions ⁷	18,502
3	Decrease due to amortization of excess deferred taxes (ARAM) ⁸	(4,666)
4	Increase due to higher rate base ⁹	1,184
5	Increase in revenue requirement due to lower taxes on equity return on rate base effects on shareholder-funded safety investments	8,640
6	Franchise and Uncollectibles and Other Misc. Differences	(138)
7	Total Changes due to the Tax Act	(57,717)

2. Position of the Parties

On April 30, 2018 one party in this proceeding, The Utility Reform Network (TURN), filed a response to PG&E's PFM. TURN disputes PG&E's assertion that the TCJA mandates the use of the Average Rate Assumption Method to return excess tax reserves to customers (*see* line 3 in Table 1 above,

⁵ PG&E Report at 12, Table 8, "Summary of Revenue Requirement Changes in 2018 Due to Tax Act."

⁶ PG&E Report at 4, Table 1, "2018 Equity ROR-Related Revenue Requirement Reduction."

⁷ PG&E Report at 6, Table 4, "2018 Revenue Requirement Change To Flow-Through Under New Tax Rate."

⁸ PG&E Report at 9, Table 6, "2018 Revenue Requirements Related To ARAM."

⁹ PG&E Report at 11, Table 7, "2018 Revenue Requirement Related To Changes in 2018 Rate Base."

“Decrease due to amortization of excess deferred taxes (ARAM)”). Apart from this dispute, TURN also contends that PG&E has not provided sufficient information to allow the Commission to render a fully informed decision on PG&E’s proposals. TURN recommends that the Commission take the following actions in response to PG&E’s PFM:

1. Adopt the revenue requirement changes as set forth in PG&E’s petition on an interim basis (as modified based on TURN’s other arguments), subject to further reduction after the IRS clarifies the proper use of ARAM to return excess tax reserves to customers.
2. Direct PG&E to obtain an IRS Letter Ruling regarding the proper use of ARAM.
3. Require PG&E to provide additional information that TURN believes is necessary to fully analyze the various categories of PG&E’s Accumulated Deferred Income Taxes (ADIT), and provide parties a further opportunity to address whether the proposed treatment of each category is appropriate.

Today’s decision is based on consideration of the written pleadings of PG&E and TURN.

3. Discussion

In the sections that follow, we address PG&E’s estimated TCJA-related revenue requirement changes, as presented in Table 1 above.

3.1. Decrease in Revenue Requirements Due to Lower Taxes on Equity Return on Rate Base

The first item listed in Table 1 above is a significant reduction of the revenue requirement necessary to fund PG&E’s authorized return on common equity. Although offset by other increases, as shown above on Line 1 of Table 1 this reduction accounts for a \$81.239 million ratepayer benefit in 2018.

PG&E’s Commission-authorized rate of return (ROR) on its rate base is 7.69%, which is the sum of the weighted cost of its authorized return on long-term debt, preferred stock, and common equity. The calculation shown

below reflects the method adopted by the Commission in D.12-12-034; since that time, PG&E made Commission-authorized filings that reduced the weighted cost of its authorized return on common equity from the 5.39% used in PG&E's PFM calculations, to the current value of 5.33%.

**PG&E's Authorized Cost of Capital
and Authorized Return on Rate Base
for its Electric and Gas Operations¹⁰**

		Cost Factor	Capital Ratio	Weighted Cost
Line No.		(a)	(b)	= (a) x (b)
1	Long-term Debt	4.89%	47.0%	2.30%
2	Preferred Stock	5.60%	1.0%	.06%
3	Common Equity	10.25%	52.0%	5.33%
4	Authorized Return on Rate Base			7.69%

PG&E explains in its PFM that its return on common equity represents the Company's net earnings and as such is subject to income taxes.¹¹ This estimated tax expense, in turn, is a standard item included in every rate case-related revenue requirement, to be collected from ratepayers as part of the rates they pay for electricity and natural gas.

Pursuant to standard cost-of-service ratemaking practices, federal and state income tax expenses are incorporated into the rate case-related revenue requirement by means of a factor based on expected income tax rates (the "Income Tax Gross-Up"). PG&E's calculations show that the TCJA's reduction in the federal income tax rate results in a corresponding reduction in the income tax gross-up from roughly 1.78 to roughly 1.42. The use of the lower factor directly

¹⁰ D.12-12-034, Ordering Paragraph 4, updated by PG&E in Advice Letter 3887-G/5148-E.

¹¹ PFM, Attachment B at 3. PG&E further explains that the debt-related ROR is financed by interest expense, which is tax deductible and therefore does not require a tax recovery or a gross-up. The TCJA did not change the tax deduction for interest expense for public utilities. *Id.* at 4.

reduces the amount by which PG&E's GT&S revenue requirement must be increased to account for taxes.

Table 2 below reproduces PG&E's calculation of the isolated impact of the TCJA on PG&E's ROR in 2018 due to the lower corporate income tax rate (*i.e.*, this calculation intentionally ignores the additional effects on rate base due to the TCJA, which we discuss in a later section of this decision). The \$81.239 million decrease in revenue requirement shown in Table 2 results from both the lower income tax gross-up (Line 4) and lower combined tax rates (Line 6).

The methodology used by PG&E in its calculation is undisputed. Based on our own review, we find it to be reasonable. PG&E should use the same method in any revisions made to this line item in compliance with this decision.

Table 2
2018 Equity ROR-Related Revenue Requirement Reduction (\$000)

Line No.	Item	New Tax Rate	Old Tax Rate	Difference
1	Total rate base adopted in D.16-05-056	4,241,964	4,241,964	
2	Equity rate of return	5.39%	5.39%	
3	Equity return on rate base	228,642	228,642	
4	Income tax gross-up	1.425313	1.780627	
5	Revenue requirement	325,886	407,126	
6	Combined tax rate	29.84%	43.83%	
7	Revenue requirement attributable to income taxes	97,244	178,484	
8	Revenue requirement reduction resulting from lower tax rate			(81,239)

3.2. Increase in Revenue Requirements Due to Lower Taxes on Flow-Through Tax Deductions

The second item listed in Table 1 above is an increase to PG&E's tax-related revenue requirement due to the effect of the lower tax rate on

flow-through tax deductions. As shown in Line 2 of Table 1 the result is a \$18.502 million increase in 2018.

PG&E uses the flow-through accounting method to reflect certain tax deductions in its GRC revenue requirement. Under this approach, PG&E simply estimates its expected test year tax return deductions and includes those benefits in its final calculation of the revenue requirement. The tax benefit reflected in the revenue requirement is equal to the forecasted cash savings. When tax rates are reduced, this reduces the forecasted tax benefit and increases the forecasted income tax expense, resulting in a higher revenue requirement. However, the future tax expense when a flowed-through tax benefit is reversed (flowed-back) will also be at the lower tax rate. This will reduce the future revenue requirement, which PG&E considers a long-term future benefit to customers.

PG&E has three types of net flow-through tax adjustments, which must be calculated separately because the applicable income tax rates are different:

(1) tax deductions where the federal and state amounts are the same, (2) federal-only tax deductions, and (3) state-only tax deductions. We present Tables 3, 4 and 5 together on the following page to show how PG&E developed the estimated change in its 2018 revenue requirement. First, Table 3 calculates PG&E's revenue requirement under the old tax rate. Second, Table 4 calculates PG&E's revenue requirement under the new tax rate. Lastly, Table 5 compares the old and new revenue requirements, which shows a net \$18.502 million reduction in the tax benefit from the amount included in the 2018 revenue requirement authorized in D.16-06-056. PG&E's 2018 GT&S revenue requirement must now be increased by that amount.

The methodology used by PG&E in its calculations is undisputed. Based on our own review, we find this approach to be reasonable. PG&E should use

the same method in any revisions made to this line item in compliance with this decision.

Table 3
2018 Revenue Requirements Related To Flow-Through Under Old Tax Rate (\$000)

Line No.	Item	Federal and State	Federal Only	State Only	Total
1	Tax deductions	47,358	(10,834)	165,070	
2	Income tax rate	43.83%	35.00%	8.84%	
3	Income tax change	20,762	(3,792)	14,592	
4	Income tax gross-up	1.780627	1.780627	1.780627	
5	Revenue requirement change from flow-through tax deductions	36,969	(6,752)	25,983	56,200

Table 4
2018 Revenue Requirements Related to Flow-Through Under New Tax Rate (\$000)

Line No.	Item	Federal and State	Federal Only	State Only	Total
1	Tax deductions	47,358	(10,833)	165,070	
2	Income tax rate	29.84%	21.00%	8.84%	
3	Income tax change	14,132	(2,275)	14,592	
4	Income tax gross-up	1.425313	1.425313	1.425313	
5	Revenue requirement change from flow-through tax deductions	20,142	(3,242)	20,798	37,698

Table 5
2018 Revenue Requirement Change To Flow-Through Under New Tax Rate (\$000)

Source	Revenue Requirement	Federal and State	Federal Only	State Only	Total
Table 3, line 5	Revenue requirement reduction from flow-through tax deductions using <u>old</u> tax rate	36,969	(6,752)	25,983	56,200
Table 4, line 5	Revenue requirement reduction from flow-through tax deductions using <u>new</u> tax rate	20,142	(3,242)	20,798	37,698
Total change in revenue requirement ("old" minus "new")					28,502

3.3. Decreases in Revenue Requirements Due to Amortization of Excess Accumulated Deferred Income Taxes

The third line in Table 1 above shows PG&E's estimates of the decrease in its revenue requirements due to the method PG&E proposes to apply to amortize the excess of deferred taxes that have been created by the lower tax rate. PG&E proposes reductions equal to \$4.666 million in 2018 (*see* Line 3 of Table 1). PG&E's calculation of the 2018 value is shown in Table 6 below.

Table 6
2018 Revenue Requirements Related to ARAM (\$000)

Line No.	Item	New Tax Rate
1	Federal ARAM adjustment	(3,274)
2	Income tax gross-up	1.425313
3	Revenue requirement impact of ARAM	(4,666)

TURN challenges PG&E's choice of methodology for these calculations, and the proposed reductions that result, contending that "the utility has not provided a complete or appropriate method for identifying and returning Excess ADIT."¹² We turn to that discussion now.

3.3.1. Background

TURN's disagreement with PG&E has to do with the interaction between the utility's depreciation practices and the tax benefits associated with those practices. Like all utilities regulated by this Commission, PG&E accounts for depreciation expenses using one method for ratemaking purposes (straight-line depreciation) and a different method for tax purposes (accelerated depreciation). While straight-line depreciation reduces the value of an asset by the same annual amount over the life of the asset, accelerated depreciation allows a utility to reduce that value by larger amounts early in the life of the asset, and lower

¹² TURN Comments at 2.

amounts in later years. Because depreciation is an expense, using the accelerated method will reduce a utility's net income more in those earlier years than would be the case if straight-line depreciation were used. The lower net income, in turn, reduces the utility's income tax obligation. However, this benefit "reverses" in later years of the life of an asset, when the asset is fully depreciated for tax purposes, leaving no depreciation expenses to offset net income.

Under normal cost-of-service ratemaking principles, regulatory commissions would pass the tax savings that result from accelerated depreciation straight through to ratepayers in the form of a reduced revenue requirement and lower rates. However, Congress adopted accelerated depreciation in order to stimulate investment, and discouraged regulatory commissions from passing along the savings by requiring that utilities using accelerated depreciation for an asset for tax purposes must also comply with "normalization" rules that require that, for ratemaking purposes, the same asset be depreciated over the entire useful life of the asset, via straight-line depreciation.

As a result of the normalization requirement, customer rates collect more taxes than the utility actually pays the IRS in the early years of the underlying asset, but less taxes than are necessary in later years. The utility establishes a "deferred tax reserve account" to record the difference between the straight-line depreciation expense and the accelerated depreciation expense. These funds are labeled Accumulated Deferred Income Taxes (ADIT). The utility then draws down that reserve as the accelerated depreciation benefits for a particular asset reverse.

3.3.2. The Impact of the TCJA on Excess ADIT

The use of normalized accounting is viewed as a means of “protecting” the funds made available by accelerated depreciation, which Congress intended be used for investment, from the reach of regulatory commissions intent on flowing these excess funds back to ratepayers. Instead, the ADIT associated with these “protected” assets must be returned to ratepayers according to an amortization schedule determined by the IRC. This methodology is known as the Average Rate Assumption Method (ARAM). Congress also directed that failure to use the ARAM where it is required is considered a “normalization violation” that the IRS penalizes by withdrawing the option for the utility to take advantage of accelerated depreciation in the future¹³

Turning now to the impact of the TCJA on these accounting practices, TURN succinctly explains in its comments that “with the reduction in federal taxes from 35% to 21%, approximately 40% of federal ADIT on [PG&E’s] books at the end of 2017 immediately became excess ADIT (money that PG&E had collected but will not need to pay for future federal taxes).”¹⁴ TURN and PG&E do not disagree that excess ADIT should be returned to ratepayers, but they do disagree over how the excess amount should be calculated, and how quickly that amount should be repaid. These disagreements are based on each party’s interpretation of the IRC regarding these questions.

PG&E calculated the value to be returned to ratepayers in 2018 (the \$4.666 million shown in Table 6 above, and on line 3 of Table 1 above) based on its assumption that the TCJA now requires all excess ADIT to be returned

¹³ The ARAM requires that excess ADIT be reversed as the book/tax difference reverses, meaning that a normalization violation occurs if the excess ADIT is used to reduce rates more rapidly than the reversal of the book/tax difference turnaround takes place.

¹⁴ TURN Comments at 2, emphasis added.

according to the ARAM.¹⁵ TURN agrees with PG&E that excess ADIT that is subject to ARAM requirements must be amortized on a schedule that avoids a normalization violation, but TURN disagrees with PG&E regarding whether all excess ADIT is really subject to those requirements. TURN contends that the Commission has discretion regarding how it may direct PG&E to return certain categories of excess ADIT to ratepayers. TURN separates excess ADIT into three categories for the Commission's consideration.

3.3.3. The Three Categories of Excess ADIT

The first category of excess ADIT has its source in protected assets, as we described above. TURN acknowledges that most of the excess ADIT that PG&E identifies in its PFM is the result of accelerated depreciation, and is thus a "protected" asset; TURN agrees with PG&E that this category of excess ADIT must be returned to ratepayers using the ARAM. However, TURN also notes that where excess ADIT arose for reasons unrelated to accelerated depreciation, it is considered "unprotected" by the IRC and is therefore not subject to ARAM. Thus, a second category of ADIT may also be plant-related, but is considered "unprotected" by the IRC because it is categorized by provisions of the IRC unrelated to accelerated depreciation. Finally, a third category of excess ADIT derives from assets that are not related to utility plant at all (*e.g.*, vacation pay).¹⁶

In past GRCs this Commission approved the application of normalization rules to unprotected assets, even though that was not required by the IRC, to ensure that all ratepayers served by the asset over its useful life are treated equally. This is consistent with Pub. Util. Code § 454.8, which provides guidance

¹⁵ PG&E Report at 2 and 8.

¹⁶ TURN Comments at 2.

to this Commission regarding proper recovery from ratepayers of the costs of new utility construction:

In any decision establishing rates for an electrical or gas corporation reflecting the reasonable and prudent costs of the new construction of any addition to or extension of the corporation's plant, when the commission has found and determined that the addition or extension is used and useful, the commission shall consider a method for the recovery of these costs which would be constant in real economic terms over the useful life of the facilities, so that ratepayers in a given year will not pay for the benefits received in other years.

That said, although we agree that the benefit of deferred taxes should be normalized so that ratepayers are treated equally over time, we do not agree with deferring the return of excess funds if this is not required by statute or regulation. We prefer that such funds be returned to ratepayers now. Unlike requiring all ratepayers to share equally in the expense of an asset over its useful life, returning excess funds to current ratepayers does not impose a greater burden on future ratepayers. Rather, repayment now returns the excess funds to ratepayers who are the closest in time to the recent ratepayers who contributed those funds to these accounts.

The problem before us with respect to our review of PG&E's estimated reduction of \$4.666 million is that PG&E calculated this value based on its assumption that all excess ADIT is protected, and therefore subject to the ARAM. As TURN points out in its comments, PG&E's PFM does not distinguish between protected excess ADIT and unprotected excess ADIT and provides no analysis of where the use of ARAM is required and where it is not. TURN therefore contends that the Commission does not have enough information to make a final decision on how to identify unprotected ADIT, and how to return those amounts

to ratepayers quickly.¹⁷ We address TURN's contention at the end of this section of this decision.

3.3.1.1 Excess ADIT Related to Cost of Removal

TURN's comments also highlight a separate issue within the debate over excess ADIT, a matter this Commission recently addressed in its decision on Southern California Edison's General Rate Case (GRC) application (D.19-05-020 in Application (A.) 16-09-001).¹⁸

This issue is the proper treatment of "cost of removal" in these calculations. Textbooks define depreciation expense as equal to the initial cost of an asset, minus whatever value can be recovered at the end of the asset's useful life after it is fully depreciated (its salvage or "scrap" value). For example, if the cost of the asset is \$10,000 and the firm expects its salvage value to be \$1,000 then the depreciation expense is \$9,000. However, utility assets are typically considered to have negative salvage value because the "cost of removal" (or COR) is expected to exceed any scrap value that may exist. In the example just given, if the cost of the asset is \$10,000 but the expected salvage value is \$0 and the expected COR is \$1,000 then the depreciation expense is \$11,000.

PG&E has historically included COR when it calculates its total book depreciation expense, which means that part of the excess ADIT resulting from the TCJA is the COR that ratepayers have been funding over the years. However, PG&E changed its historical practice in its PFM, and excludes COR from book depreciation when it applies the ARAM to calculate the amount of excess ADIT that it recommends be returned to ratepayers. As TURN explains,

¹⁷ TURN Comments at 5.

¹⁸ D.19-05-020 in A.16-09-001.

When comparing book depreciation and tax depreciation for purposes of ARAM, the inclusion of the entire amount of depreciation (including both recovery of the original cost of capital investments and the future cost of removal) has a material effect on the outcome. By including only the amount of depreciation associated with recovery of the original cost of capital investments, PG&E's calculations result in a smaller near-term adjustment.¹⁹

TURN states that it has not estimated the impact of the two possible treatments of COR, but expects that it is a material difference because that was the case for the same issue in Southern California Edison Company's (SCE) test year 2018 General Rate Case proceeding (A.16-09-001).²⁰

TURN cites the importance of avoiding normalization violations, and recommends that the Commission approve PG&E's estimated revenue requirement reductions (as modified based on TURN's other arguments), but also order PG&E to (1) request a private letter ruling (PLR) from the IRS as to whether the use of the entirety of book depreciation is appropriate for computing ARAM, or only the portion excluding net salvage; and (2) track the difference between the use of (i) ARAM as set forth in its PFM calculations and (ii) ARAM as defined using the entirety of depreciation, including net salvage.²¹

TURN made its recommendations before we addressed the same issue in our decision on SCE's GRC application. There, we took TURN's recommendations a step further and directed SCE to reduce its revenue requirements immediately in its post-decision rate change, rather than waiting until receiving a PLR from the IRS on the COR question. Our directives were

¹⁹ TURN Comments at 3-4.

²⁰ *Id.* at 4.

²¹ TURN Comments at 4-5.

supported by the following Conclusions of Law in D.19-05-020, which state in relevant part:

- The benefits of the TCJA should flow to the ratepayers (*see*, Conclusion of Law (COL) 194).
- Ratepayers should begin receiving the benefit of the TCJA now and continuing through the remainder of SCE's 2018-2020 GRC cycle (*see*, COL 195).
- SCE should normalize the benefits of the TCJA including deferred taxes reflected on SCE's regulatory books of account based on the differences between SCE's regulatory tax liability, including Cost of Removal, and its actual tax liability, as calculated on its actual depreciable basis (*see*, COL 189).²²
- The net excess deferred taxes relating to unprotected assets should be returned to ratepayers. Consistent with the return of other funds due to implementation of the TCJA, these funds should be returned on an amortized basis over the remainder of SCE's 2018-2020 GRC cycle (*see*, COL 190).

We intend to apply the same policies to PG&E's PFM proposals as we did in D.19-05-020. PG&E has consistently normalized the benefits of accelerated depreciation derived from its depreciable basis and it is our intention that PG&E continues to normalize the benefits of the TCJA.²³ Historically, PG&E has included COR in its calculation of ADIT. To change now and exclude COR from the ARAM calculation would increase the tax expense for current customers in excess of the benefit they received from the asset: the result is the COR is no longer normalized, despite it being a cost which should be shared equally by all

²² In D.19-05-020 the Commission notes that this is consistent with IRC Section 168(i)(9)(A)(i) and Treasury Regulation § 1.167(l) 1(h)(1)(iii). *See*, COL 189 in full and discussion at 294-297.

²³ We repeat our reference from D.19-05-020 at 296, footnote 680: Taxpayers have a duty to treat items consistently. *See Unvert v. Commissioner*, 72 T.C. 807, 814 (T.C. 1979) ("there is a duty of consistency as to [tax] treatment, and one should be held to the consequences of the initial treatment.")

ratepayers. Therefore, we believe it is consistent with the IRC normalization rules for us to require PG&E to continue to include COR in its calculation of excess ADIT when calculating ARAM.

In reaching this determination, we fully intend that PG&E continue to comply with applicable normalization rules. We believe we have reached the correct result, and, as TURN observes on page 4 of its Comments, PG&E has not cited to any written determination, case, regulation, or statute to support its position. Nevertheless, just as we did in D.19-05-020 for SCE, we acknowledge that PG&E may request a PLR from the IRS on this question. In the event that PG&E requests a PLR and subsequently receives an IRS ruling stating normalization rules do not apply to COR in the ARAM calculation for the return of excess deferred taxes to ratepayers, PG&E shall comply with the IRS's interpretation of the applicable tax laws by filing a Tier 2 advice letter with this Commission to seek an appropriate adjustment to its revenue requirement and/or rate base. In the meantime, we agree with TURN that PG&E should track the difference that results from (i) the use of ARAM as set forth in PG&E's Attachment B report and (ii) ARAM as defined using the entirety of depreciation including net salvage.

3.3.4. Next Steps Regarding Excess ADIT

We concluded our discussion above regarding the three categories of excess ADIT by echoing TURN's observation that PG&E's PFM does not distinguish between protected excess ADIT and unprotected excess ADIT and provides no analysis of where the use of ARAM is required and where it is not. We face the same problem with respect to PG&E's treatment of COR in its calculations. At the same time, we intend that the benefits of the TCJA be returned quickly to PG&E's ratepayers where it is allowed by the IRC. TURN

recommends that the Commission require PG&E to essentially go back to the drawing board and provide a list of all individual components of accumulated deferred tax assets and liabilities, along with extensive additional information for each component. At that point, TURN suggests “[o]nce this information is made available to the parties, the Commission can determine the appropriate method for returning to customers the Tax Act reductions associated with specific assets and accounts.”²⁴ TURN’s analysis of the problem facing us is excellent, but we do not believe the solution necessitates that we order PG&E to produce additional data. We did not require this of SCE, and we are also intent on closing out PG&E’s PFM now, so that PG&E’s customers can begin receiving the benefits of the TCJA to which they are entitled. We discuss our preferred solution below in the “ratemaking implementation” section of this decision.

3.4. Increases in Revenue Requirements Due to Higher Rate Bases

The fourth material item listed in Table 1 above is PG&E’s estimate of the increase in its post-TCJA revenue requirement due to higher rate base. As shown on line 4 of Table 1, PG&E estimates its revenue requirement will increase by \$1.184 million in 2018. This is due to four direct impacts of the TCJA on PG&E’s rate base:

1. lower deferred federal income taxes from applying MACRS instead of bonus depreciation (as PG&E noted in its PFM Report, the TCJA ended the option to use bonus depreciation);
2. new deferred taxes accruing at the lower tax rate;
3. the ARAM amortization of protected and unprotected excess tax reserves; and
4. working cash.

²⁴ TURN Comments at 6.

The details of PG&E's estimates are shown in Table 7 below.

First, the combined impacts of PG&E's items (1) through (3) are shown on Line 1, "Deferred Income Taxes." Since deferred taxes are an offset credit against rate base, reductions in deferred tax amounts will increase rate base in the three ways listed by PG&E: applying MACRS instead of bonus depreciation for most of the asset additions after September 27, 2017 reduces deferred taxes. In addition, new tax timing differences arising after 2017 are tax-affected at the lower 21% tax rate, which results in lower new deferred taxes. Finally, ARAM amortization of excess tax reserves also acts to increase rate base when the amortized amounts reduce revenue requirements.

Second, the impact of PG&E's item (4) is shown on Line 2 of Table 7, "Working Cash." Although the ARAM amortization of excess tax reserves acts to increase rate base, this also affects the Working Cash calculation within the RO model; Working Cash is adjusted for changes in Income Taxes, Deferred Taxes and Other Expense Items, and these adjustments made to Working Cash to conform with the Tax Act typically result in decreases to rate base. However, in this instance PG&E estimated no impact so the entry on Line 2 of Table 7 is \$0.

Table 7
2018 Revenue Requirement Related to 2018 Rate Base Changes (\$000)

Line No.	Item	Debt Return on Rate Base	Equity Return on Rate Base	Total
	Deferred income taxes	11,858		
2	Working cash	0		
3	Total rate base changes	11,858	11,858	1,858
4	Rate of Return	2.30%	5.39%	7.69%
5	Return on Rate Base	273	639	912
6	Income tax gross-up	1.0000	1.425313	--
7	Revenue requirement	273	911	1,184
8	Income tax rate		29.84%	
9	Revenue requirement attributable to income taxes		272	272

The methodology used by PG&E in its calculations is undisputed. Based on our own review, we find this approach to be reasonable. PG&E should use the same method in any revisions made to this line item in compliance with this decision.

4. PG&E's Update of Appendix G of D.16-12-010

As PG&E explains in its Report, the TCJA also impacts the values previously adopted by the Commission in D.16-12-010, its decision that allocated the \$850 million San Bruno disallowance between the overall GRC categories of current expenses and long-term capital investments. The RO modeling that supported D.16-12-010 included estimates of its effects on PG&E's annual income tax expense, so those must be revised now in order to be consistent with the provisions of the TCJA. The Commission's adopted revenue requirement reduction was shown in Appendix G of D.16-12-010. PG&E's PFM Report includes an updated Appendix G that reflects the applicable effects of the TCJA.²⁵ Although PG&E does not show all the calculations, we note that line 6 of Table 1 of this decision shows a \$8.64 million "increase in revenue requirement due to lower taxes on equity return on rate base effects on shareholder funded safety investments." PG&E calculates a reduction in 2018 taxable income equal to \$28.890 million in Appendix 1, Table 4 of its PFM Report, and the difference between subjecting that income to the pre-TCJA "combined tax rate" (68.765%) and the post-TCJA "combined tax rate" (38.857%) is equal to an increase of \$8.64 million.

²⁵ PG&E Report, Appendix 1, Table 4, "2015 GT&S - PG&E Revenue Requirement Impact of Rate Base Adjustment in 2015 and 2016, Appendix G revised to include the Tax Act." PG&E explains elsewhere in Appendix 1 that it has also revised the tables from D.16-12-010 to include updates reflecting the 2018 Uncollectible factor and the 2018 Cost of Capital as approved by D.17-07-005. These updates are reasonable.

The methodology used by PG&E in its calculations is undisputed. Based on our own review, we find this approach to be reasonable. PG&E should use the same method in any revisions made to this line item in compliance with this decision.

5. Ratemaking Implementation

As we discussed above, consistent with our approach in D.19-05-020 for SCE, we intend that where the TCJA created benefits that can be passed on immediately to its customers, PG&E provide this rate relief as soon as possible. However, in the SCE proceeding we were able to implement our modifications to SCE's proposal immediately, as part of the overall RO modeling as we prepared D.19-05-020, which incorporated all of our determinations regarding SCE's GRC application, including our decisions regarding the TCJA. The situation is somewhat different for PG&E.

Although PG&E's PFM provided precise estimates of the effects of the TCJA on its 2018 GT&S revenue requirement, in this decision we determine that PG&E should revise those estimates in two ways:

- i. PG&E should revise its estimated revenue requirement reductions to quantify the amount of unprotected excess ADIT, which can be returned to ratepayers without following ARAM.
- ii. PG&E should revise its calculation of the revenue requirement impact of the use of ARAM where it is required (line 3 in Table 1 of this decision) so that the Cost of Removal is included in book depreciation when calculating the amount of protected excess ADIT which can be returned to ratepayers.

TURN has demonstrated that PG&E's calculations – though quite detailed – were not prepared in a way that would allow this Commission, or TURN and other parties, to revise PG&E's estimates in the two ways listed above without PG&E's

assistance. Therefore, we will direct PG&E to implement the post-TCJA reductions in the manner described below.

In its PFM, PG&E proposes to work collaboratively with the Commission's Energy Division to determine the appropriate timing for providing the revenue requirement revisions adopted in this decision to its customers, with consideration of possible impacts on customer rates due to other factors. We find this approach appropriate, with some additional guidance regarding the Energy Division's role.

First, PG&E should revise its calculations of the post-TCJA revenue requirement reductions in 2018 according to our instructions listed above. Staff from the Commission's Energy Division should be consulted by PG&E as these revisions are prepared, and PG&E should provide workpapers with its revised calculations for review by parties in this proceeding, as part of the Advice Letter filing described below.

Second, PG&E should work collaboratively with the Energy Division to determine the proper length of time over which the revised reductions should be amortized in rates. We emphasize that we expect these funds to be returned to ratepayers over as short a period of time as possible. The proposal PG&E develops in collaboration with the Energy Division should fully explain how the return of these funds interacts with other upcoming rate changes contemplated by PG&E. As with its revised revenue requirement reductions, this proposal should also be supported by detailed workpapers that will enable other parties in this proceeding to review and comment on PG&E's proposed amortization period.

PG&E should file the revised revenue requirement reductions and the associated amortization proposal in a Tier 2 Advice Letter, as instructed in the Ordering Paragraphs of this decision.

6. Comments on Proposed Decision

The proposed decision of Administrative Law Judge (ALJ) Allen in this matter was mailed to parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____ by _____.

7. Assignment of Proceeding

Michael Picker is the assigned Commissioner and Peter V. Allen is the assigned ALJ in this proceeding.

Findings of Fact

1. On June 23, 2016 the Commission adopted D.16-06-056, authorizing 2015-2018 revenue requirements on an interim basis for PG&E's GT&S.
2. On December 1, 2016 the Commission adopted D.16-12-010, which finalized the interim revenue requirements adopted in D.16-06-056 and corrected a minor technical error included in D.16-06-056.
3. The revenue requirements adopted in D.16-06-056 and D.16-12-010 were based upon corporate income tax rates in effect at the time the Commission adopted those decisions.
4. On December 22, 2017, Pub L. 115-97, the TCJA was signed into law, enacting new federal tax laws and making changes to the IRC that substantially impact PG&E beginning in the tax year 2018. These impacts were not

incorporated into the 2018 GT&S attrition year revenue requirements adopted in D.16-06-056 and D.16-12-010.

5. Pursuant to its PFM of D.16-06-056 as later modified by D.16-12-010, PG&E calculated the changes resulting from the TCJA, yielding a 2018 GT&S attrition year revenue requirement reduction of \$57.717 million.

6. The deferred income taxes reflected on PG&E's regulatory books of account are based on the differences between PG&E's regulatory income tax liability and its actual income tax liability, calculated on its actual depreciable basis and consistent with IRC requirements.

7. ARAM requires that excess income tax reserves be refunded to customers based on a normalization method, so that they are returned over the regulated book life of the underlying plant that generated the original reserves.

8. In its 2015 GT&S application, PG&E included COR in book depreciation when calculating the deferred income tax reserve accrued through December 31, 2017. Conversely, in this PFM PG&E's ARAM amortization calculation does not include new COR accrued for book purposes after December 31, 2017. The difference caused by removing COR when calculating the ARAM is likely to have a material impact on the amount of funds that are returned to PG&E's customers.

9. Certain utility assets are not subject to normalization rules. These assets are typically referred to as "unprotected" assets.

Conclusions of Law

1. The PFM of D.16-06-056 should be granted in accordance with the ordering paragraphs below.

2. The reductions to PG&E's 2018 GT&S revenue requirement due to the TCJA should be passed on immediately to PG&E's customers, to the extent allowed by law.

3. PG&E's proposal to apply ARAM to amortize unprotected excess deferred taxes is not required by law.

4. It is reasonable to require that the net excess deferred taxes relating to unprotected assets be returned to current ratepayers.

5. PG&E should revise its estimated 2018 revenue requirement reductions to quantify the amount of unprotected excess ADIT which can be returned to ratepayers without following ARAM.

6. PG&E should revise its calculation of the revenue requirement impact of the use of ARAM where its use is required so that the COR is included in book depreciation when calculating the amount of protected excess ADIT which can be returned to ratepayers.

7. Returning excess deferred income taxes to current ratepayers does not impose a greater burden on future ratepayers. Rather, repayment now returns excess deferred taxes to ratepayers who are the closest in time to the ratepayers who contributed the funds to these accounts.

8. Any changes to PG&E's post-TCJA revenue requirements should be implemented in a manner that will not be found to be a normalization violation by the IRS.

9. In the event that PG&E requests a private letter ruling from the IRS and subsequently receives an IRS ruling stating normalization rules do not apply to COR in the ARAM calculation for the return of excess deferred taxes to

ratepayers, PG&E shall comply with the IRS's interpretation of the applicable tax laws as described in the Ordering Paragraphs of this decision.

O R D E R

IT IS ORDERED that:

1. The Petition for Modification of Decision 16-06-056, filed by Pacific Gas and Electric Company, is hereby granted in accordance with the ordering paragraphs of this decision.

2. Decision (D.) 16-06-056 (as later modified by D.16-12-010) is modified to add the following new ordering paragraph 74:

In order to reflect the changes in the Tax Cuts and Jobs Act (TCJA) of 2017, the 2018 attrition amount adopted herein shall be reduced in a manner consistent with the new requirements of the TCJA, as calculated by Pacific Gas and Electric Company and submitted in a Tier 2 Advice Letter that shall take effect after approval by the Commission's Energy Division.

3. Pacific Gas and Electric Company (PG&E) shall ensure that its calculations of the revenue requirement reductions due to the Tax Cuts and Jobs Act (TCJA) of 2017 comply with the following instructions:

- i. PG&E's estimated revenue requirement reductions shall quantify the amount of unprotected excess Accumulated Deferred Income Taxes (ADIT), which can be returned to ratepayers without following the Average Rate Assumption Method (ARAM); and
- ii. PG&E's estimated revenue requirement reductions shall quantify the use of ARAM where it is required such that the Cost of Removal is included in book depreciation when calculating the amount of protected excess ADIT which can be returned to ratepayers.

4. Pacific Gas and Electric Company shall consult with the Commission's Energy Division as part of its compliance with Ordering Paragraph 3 of this decision and shall also work collaboratively with the Energy Division to

determine the proper length of time over which the estimated revenue requirement reductions should be amortized in rates.

5. Within 30 days of the effective date of this decision, Pacific Gas and Electric Company shall file the results of its compliance with Ordering Paragraphs 3 and 4 of this decision as a Tier 2 advice letter.

6. If Pacific Gas and Electric Company requests a private letter ruling from the Internal Revenue Service (IRS) concerning application or interpretation of the Tax Cut and Jobs Act, it shall file and serve a copy of its intended request as a Tier 1 Advice Letter at least 30 days before sending the request to the IRS.

7. Any request by Pacific Gas and Electric Company for a private letter ruling concerning application or interpretation of the Tax Cut and Jobs Act shall seek a response to the question, "Is including Cost of Removal/Negative Net Salvage in the Average Rate Assumption Method calculation for the return of excess deferred taxes to ratepayers inconsistent with normalization requirements?"

8. If Pacific Gas and Electric Company (PG&E) requests a private letter ruling from the Internal Revenue Service (IRS) and subsequently receives an IRS ruling stating normalization rules do not apply to Cost of Removal/Negative Net Salvage in the Average Rate Assumption Method calculation for the return of excess deferred taxes to ratepayers, PG&E shall comply with the IRS's interpretation of the applicable tax laws by filing a Tier 2 advice letter with this Commission to seek an appropriate adjustment to its revenue requirement and/or rate base.

9. Application 13-12-012 is closed.

This order is effective today.

Dated _____, at San Francisco, California.